Supreme Court, U.S.
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No. 01-1771

IN THE

Supreme Court of the United States

LAWRENCE JUST,

Petitioner,

v.

AUDREY MULLEN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF NEW YORK, APPELLATE DIVISION SECOND DEPARTMENT

BRIEF IN OPPOSITION

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The sole issue presented by the Petitioner is whether the New York Court, in calculating his income for purposes of computing his child support obligations, properly declined to deduct, dollar-for-dollar, the amount of Petitioner's voluntary and unilateral "capital contributions" made to Rodale Electronics, his own company.

Respondent, Audrey Mullen, submits that the petition for writ of certiorari should be denied. State Courts have an overwhelming and overriding interest to safeguard the rights of children to receive adequate support from non-custodial parents. The State Courts must retain the ability to resolve questions of credibility of litigants in all cases and cannot be bound by the amount of income or loss reported by a self-employed parent in his tax returns. To require the States to be bound by a litigant's computation of his or her 'income' would curtail the State's interest in fixing child support obligations that reflect the true financial circumstances of the obligor parent.

The Courts of New York State correctly rejected the Petitioner's unilateral computation of his income, in his attempt to reduce his income so as to minimize his child support obligations.

STATEMENT OF THE CASE

Petitioner is the owner of his own business, Rodale Electronics, responsible for all financial operations. In 1997, Petitioner's income from Rodale, as reported on his W-2 form, was in the sum of $88,492. (Transcripts, May 25, 1999: 48) In that same year, the Petitioner claimed that he made necessary "capital contributions" to Rodale in the sum of $41,767, (Transcripts, July 8, 1999: 45) and argued that

his total income in 1997 should be the difference, or the sum of $43,746. Similarly, for 1998, Petitioner insisted that his child support obligation should be based upon the even lower income of $30,790, which he computed by deducting optional contributions made to his own company from W-2 income he had received in that year. (Transcripts, August 23, 1999: 35) In computing his available income for child support, however, Petitioner did not include any of the multiple perquisites provided by his own company. (Transcripts, August 23, 1999: 34, 35)

As a 13.95% shareholder, Petitioner insisted that he was obliged to contribute funds in accordance with his ownership interest in the company. Petitioner asserted that his co-owner, John Clement, an 86% owner, had made similar contributions in accordance with his ownership interests. (Transcripts, July 8, 1999: 27, 28)

Petitioner further took the position that the capital contributions from each partner were obligatory, but he was unable to point to any document that supported his claim. At one point, Petitioner insisted that the Shareholder's Agreement compelled such payment, but on cross-examination, he was compelled to admit that nothing in the Shareholder's Agreement required such a contribution. (Transcripts, March 2, 2000: 5)

The testimony at the hearing made it apparent that the Petitioner had the ability to unilaterally control the amount and frequency of his "contributions." His contributions were voluntary, varied and did not follow a set pattern. Petitioner's sole witness, his assistant Terry Colford, was obliged to confirm that Petitioner's "contribution" depended upon whatever amount he felt was required at any given point in time. (Transcripts, March 2, 2000: 32, 33)

Petitioner nevertheless continued to insist that all contributions to his business should be deducted, dollar-for-dollar, from his annual income for the purposes of computing his child support obligations. However, it was revealed that such contributions were *not* deducted from his corporate income, were NOT taken from his W-2 income, and were not mandatory. Further questioning compelled Petitioner to concede that virtually all contributions were made out of other existing assets. (Transcripts, July 8, 1999: 52; August 23, 1999: 10, 18)

Although petitioner insisted that contributions were compelled by the "near insolvent" state of his business, he never produced any books or records of the business, and never produced any proof in support of such claims, relying solely upon his own self-serving testimony. While claiming that his company's financial difficulties required an infusion of capital, he offered no documentation to prove such claims. Although he claimed that his capital "contributions" were used to pay expenses of the company, Petitioner refused to produce the books and records of the business. Petitioner further elected NOT to produce his partner, Mr. Clement, as a witness. In short, the "contributions" made to the company from Petitioner's other investments and assets might well have been nothing more than a movement of capital from one asset to another in order to create a paper "loss". Indeed, the funds could well have been transferred to other investments held by Rodale.

On cross-examination, it became apparent that Petitioner's claims of reduced income were not matched by any deterioration in his standard of living. While testifying that his income had steadily declined since 1994 (Transcripts, July 8, 1999: 23-25), such decline did not dissuade Petitioner from *increasing* his personal expenditures.

On cross-examination, it was disclosed that in 1997, the very year in which he claimed the need to make a capital contribution of $41,767 to rescue his corporation from "near insolvency", the Petitioner also made the decision to purchase a new home, increasing his monthly mortgage from $500 to $2,200, a four-fold increase. Refusing to offer any explanation for his actions, Petitioner confirmed that in 1997, he sold the house he had owned and occupied for twenty years (Transcripts, October 18, 1999: 10) with a mortgage balance of $8,000 and a monthly obligation of $500, and bought a new home with a mortgage of $184,000 and monthly payments of $2,2000. (Transcripts, October 18, 1999: 9-13)

Depositions revealed that upon the sale of his house, Petitioner received a net of approximately $145,000 in cash. He elected to take out a very substantial mortgage rather than utilize the proceeds from the sale to reduce the new mortgage obligation and his monthly payment. This was inconsistent with Petitioner's claims of dramatic financial losses.

Testimony disclosed that Petitioner was current in all of his personal mortgage payments, and was "never more than thirty days late" with a payment. (Transcripts, October 18, 1999: 29-30) It was further revealed that in 1999, he was continuing to make regular contributions to his 401K plan (Transcripts, October 18, 1999: 31), and that contributions made by any corporate employee were matched by the corporation. (Transcripts, March 2, 2000: 59-60)

REASONS FOR DENYING THE WRIT

In computing the amount of Petitioner's income for purposes of calculation of his child support obligation, the Court exercised its discretion not to accept statements set forth in the Petitioner's tax return. The Court further exercised its authority to impute income to the Petitioner based upon his *ability* to earn, rather than his self-serving claims of manipulated income.

In order to serve the best interests of children and to ensure that children are supported in accordance with their parents' true financial ability, State Courts must be free to disallow items that appear contrived or manipulated to create the illusion of reduced income.

It is of paramount importance that the State Courts, in order to protect the rights of its children to receive adequate support from parents, retain the right to find a litigant's testimony unworthy of credibility, whether such testimony consist of open-court sworn testimony or statements made in a tax return prepared by or on behalf of a self-employed taxpayer.

Accordingly, based upon all available testimony, the New York Courts properly found Petitioner's representations of his own income to be inaccurate and misleading.

I.

THIS CASE INVOLVES THE APPLICATION OF THE WELL-ESTABLISHED RULE THAT A TRIAL COURT MUST HAVE THE POWER TO FIND TESTIMONY INCREDIBLE

The Courts must have the power to make independent determinations as to the credibility of a litigant. Inherent in such power is the ability to reject statements or computations of income and/or losses set forth in a tax return.

A. Statements Made In A Tax Return Are Properly Subject To Review and Challenge For Purposes of Credibility

The Petitioner's position that all statements on a litigant's tax return, including statements of sub-chapter S corporate losses, should be taken at face value, finds no support in the law. The mere fact that an item appears as a "deduction" on a tax return does not then automatically require a Court or even the Internal Revenue Service to accept the return or the claimed "loss" at face value. Indeed, the Internal Revenue Service regularly audits returns and, notwithstanding the definitions of "income" as set forth in the Code and Regulations, may conclude with a determination that conflicts with the taxpayer's own calculation of income.

The definition of "income" and "losses", as set forth in Internal Revenue Code and Regulations cannot be interpreted in such a manner as to restrict the ability of any reviewing tribunal, whether a State Court or the Internal Revenue Service, to reject a taxpayer's self-serving claims.

A Court is not required to accept a party's account of his or her own finances, and Courts have frequently observed that figures set forth on tax returns do not have to be accepted as income in determining child support obligations. *Liebman v. Liebman*, 229 A.D.2d 778, 645 N.Y.S.2d 581 (3d Dep't 1996.) There is nothing in any statute that requires a Court or other reviewing tribunal to accept tax returns at face value, nor should the State Court be bound to do so.

In computing income for the purposes of determining child support obligations, the Courts frequently look beyond the information set forth in a tax return. The Court can, for example, add into income any personal expenses paid by a corporation, even if such items are not listed on the tax return. *Comm. Of Soc. Services on behalf of Bryan S. v. Richard S.*, 135 Misc.2d 98, 515 N.Y.S.2d 168 (St. Lawrence Co., Family Court 1987.)

It is acknowledged that Petitioner's business is structured as a subchapter S corporation. As such, the Courts of New York and other jurisdictions have held that passive income from a subchapter S corporation does constitute income for the purposes of determining child support. *Gianniny v. Gianniny*, 256 A.D.2d 1079, 683 N.Y.S.2d 769 (4th Dep't 1998). *Anderson v. Anderson*, 60 Ark. App. 221, 963 S.W.2d 604 (1998), *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999).

However, the Courts have also held that corporate losses claimed on a tax return will not and should not automatically serve as a reduction in income for purposes of computing child support, where the husband has continued to receive a salary from the corporation and his lifestyle remains

unchanged, *Kuhn v. Bovier*, 268 A.D.2d 806, 701 N.Y.S.2d 748 (3d Dep't 2000) or where such claimed losses do not impact upon actual earnings or do not represent actual reductions in a support obligor's personal income. *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999)

Where it is demonstrated that a party's income, spending and resources are greater than those reported on a tax return, or where that party's lifestyle is at odds with information reported on a tax return, the Court cannot and should not be bound by the information contained in the return. *Hoenig v. Hoenig*, 245 A.D.2d 262, 664 N.Y.S.2d 823 (2d Dep't 1997.) The mere fact that an item appears on a tax return should not be conclusive or binding upon a Court's determination of income for the purposes of determining a child support obligation.

II.

THE STATE COURTS, IN ORDER TO SAFEGUARD THE RIGHTS OF CHILDREN TO RECEIVE ADEQUATE SUPPORT FROM PARENTS, MUST HAVE THE POWER TO UTILIZE BROAD DEFINITIONS OF INCOME AND TO IMPUTE INCOME TO A PARENT BASED UPON ABILITY TO EARN

In child support proceedings, the Court must be permitted to utilize the broadest possible definition of income so as to ensure that litigants are not given the ability to manipulate their earnings for purposes of minimizing child support obligations.

Giving the State Courts broad authority to define the "income" of a parent obliged to pay child support requires that the Courts have the ability to disallow otherwise appropriate deductions from the computation of a litigant's income. What may be "deductible" as an offset against income in accordance with the Internal Revenue Code may be and properly should be disallowed when computing income for purposes of child support.

For example, the Courts of various jurisdictions, including New York, have clearly held that depreciation, while an allowable deduction under the Internal Revenue Code, will not be considered as a deduction against income and will not be considered in computing a parent's ability to pay child support. *Haas v. Haas*, 265 A.D.2d 887, 695 N.Y.S.2d 644 (4th Dep't 1999), *Baraby v. Baraby*, 250 A.D.2d 201, 681 N.Y.S.2d 826 (3d Dep't 1998), *Blaise v. Blaise*, 241 A.D.2d 680, 659 N.Y.S.2d 926 (3d Dep't 1997), *Labar v. Labar*, 557 Pa. 54, 731 A.2d 1252 (1999), *Smith v. Smith*, 2001 WL 459108 (Tenn. Ct. App.)

The rationale for such a rule is that depreciation deductions do not reflect an actual out-of-pocket expenditure that results in an actual reduction of the personal income of the party claiming the deduction. *Cunningham v. Cunningham*, 378 Pa. Super. 280, 548 A.2d 611, *alloc. denied*, 522 Pa. 576, 559 A.2d 37 (1989).

There are other necessary and fundamental differences between the definition of 'income' for purposes of computation of child support and the definition of 'income' for purposes of computing tax consequences. For example, the specific language of the Child Support Standards Act as enac d in New York permits the Court to compute income

based upon the income that was "*or should have been reported*" on the parent's last tax return. Family Court Act Section 413 paragraph 1(b)(5)(i). The Child Support Standards Act permits a Court to impute income to a non-custodial parent based upon what he *could* earn. By contrast, in defining income, the Internal Revenue Code does not tax potential, unrealized income or ability.

Similarly, a Court may include, as income, regular gifts or ongoing support received from a parent or other family member, while this would not constitute "income" under I.R.S. definitions. *Johnson v. Robusto*, 254 A.D.2d 828, 678 N.Y.S.2d 178 (4th Dep't 1998.)

A deduction for a bad debt, while allowable by the Internal Revenue Code as a deduction, is not permitted as a deduction against income, for the purposes of computing child support. *Carlson-Subik v. Subik*, 257 A.D.2d 859, 684 N.Y.S.2d 65 (3d Dep't 1999.) Similarly, a poor investment, resulting in a capital loss, should not be used to reduce one's income.

In making his argument, Petitioner urges that the Internal Revenue Code must be deemed the decisive indicator of what is or is not considered income for purposes of child support. Taking this argument to its logical conclusion would result in a situation in which a devious parent, looking to minimize his obligations to his children, could manipulate his finances in such a manner as to make it appear that he had no income at all.

Assume, for example, that a parent has an income of $100,000 per year. In one year, the parent elects to sell securities valued at $300,000, claiming a $100,000 loss on

the sale. Should this parent nevertheless be entitled to offset his annual income with the amount of such a claimed "capital loss"? Would this parent's income be deemed "zero" thus relieving him of all support obligations? Logic dictates that this question must be answered in the negative. It is apparent that a decline in the value of assets owned by a litigant has no bearing on income earned by that litigant.

In furtherance of its obligation to protect the rights of children to receive proper support from parents, the Courts are given and must be able to retain the right to impute income to a parent and fix support on the basis of that parent's ability to earn, rather than his actual statement of earnings. Without such ability, there would be nothing to prevent an uncooperative parent from taking a low-paying job or refusing to seek gainful employment, in order to limit his or her obligations to pay child support. The State Courts must be permitted to utilize definitions of income that are broadly construed and not limited by statements of income set forth in a tax return. Income should be imputed, for example, where the Court finds that the parent's claims of income are not in accordance with expenditures or standard of living.

In this case, not only did the Court reject statements contained in Petitioner's tax returns, but the Court determined that Petitioner's income as set forth in his W-2 reported earnings of $77,400.72 were consistent with his ability to pay support on behalf of his child.

Petitioner, who insists that for purposes of computing his child support obligations, his income was not greater than $30,790 in 1998, ignored the fact that he is a highly trained professional, with advanced degrees in tax and accounting,

and is licensed as a Certified Public Accountant. By his own testimony, Petitioner had worked for the renowned accounting firm of Coopers & Lybrand.

Judge Dounias, after reviewing all of the Petitioner's objections, made an affirmative finding that the Petitioner "is an experienced Certified Public Accountant capable of earning at least $87,116.13 per year." This finding of fact focused upon the Petitioner's *ability* to earn, given his compelling credentials and impressive experience.

To the extent that a business generates less income than might otherwise be realized, the Courts in New York State have held that a parent's obligation to pay child support is measured by his *ability* to earn, not necessarily the amount of income claimed. *Kay v. Kay*, 37 N.Y.2d 632, 376 N.Y.S.2d 443 (1975.) If a business is not prospering, then it is incumbent upon that parent to secure income commensurate with his qualifications and experience. Indeed, a Court should not be bound by the convenient and possibly contrived claim that a parent has "no income" due to the failure of his business. *Orlando v. Orlando*, 222 A.D.2d 906, 635 N.Y.S.2d 752 (3d Dep't 1995.)

Courts have the ability to impute income to a litigant on the basis of unreported or under-reported business activity, *Klein v. Klein*, 251 A.D.2d 733, 674 N.Y.S.2d 142 (3d Dep't 1998), or where the court finds that personal expenditures are charged to a business account, or paid by a business. *Barber v. Cahill*, 240 A.D.2d 887, 658 N.Y.S.2d 738 (3d Dep't 1997.) Critical to such authority is the fact, as noted by the Courts, that self-employment carries with it the ability to manipulate one's own finances. *Posson v. Posson*, 229 A.D.2d 690, 645 N.Y.S.2d 155 (3d Dep't 1996.)

After considering the relevant facts and applicable law, the State Court properly held that the Petitioner had failed to substantiate his claims of "losses" with actual documentation, testimony other than his own, or proof of any decline in his standard of living. The Court properly imputed income to the Petitioner based upon his ability, experience and demonstrated lifestyle. This is not, as Petitioner suggests, an aberration or a travesty that will send the child support world into a tailspin. To the contrary, to grant Petitioner's application would result in the potential inability of State Courts to make awards of child support in accordance with a parent's true financial circumstances.

CONCLUSION

For all of the foregoing reasons, Respondent respectfully requests that this Honorable Court deny the Petition.

Respectfully submitted,

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